



# Economic Update

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## Payroll Jobs Surge, as Economic Data Confirm Stronger Economy

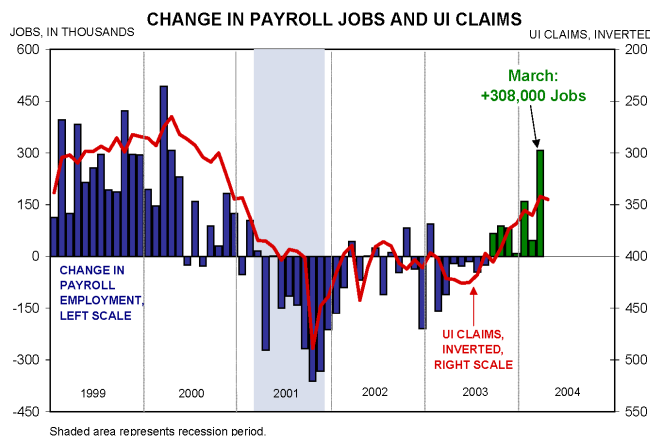
The strong gains in payroll jobs announced early this month provide a long-awaited confirmation of the U.S. economy's recovery from the slowdown and recession of 2000-01. Until last month, despite broad evidence of stronger economic performance – including a falling unemployment rate and other indications of improving labor markets – government data on establishment payroll jobs had shown only modest gains. The most recent employment data, showing 308,000 new jobs in March – and gains of more than three-quarters of a million jobs in the past 7 months – reinforce the outlook for continued strong economic growth and a sustained expansion.

Other recent data also point to a durable economic expansion. These include downward trending unemployment insurance claims; high manufacturing and non-manufacturing activity measures; strong gains in retail sales; growing business inventories; an improved outlook for business hiring; and even initial signs of inflation rather than the prior unease with possible deflation. The shift in the outlook, toward more assurance of stronger growth, also has shown up in financial markets: longer-term interest rates have risen significantly in recent weeks. Such changes should not be viewed as a surprise, however, as private and government forecasters for many months have been projecting a rise in inflation and interest rates associated with the stronger economy.

### Recent Data Confirm Stronger Economy

Recent data confirm the view that the U.S. economy has returned to a sustained expansion, a remarkable turnaround and recovery from the combination of shocks that caused the slowdown and recession of 2000-01.

- **Labor markets:** The surge in nonfarm payroll employment of 308,000 jobs in March was stronger than expected, and the largest monthly gain in 4 years. Payroll employment has now increased by 759,000 jobs over the past 7 months. The unemployment rate was



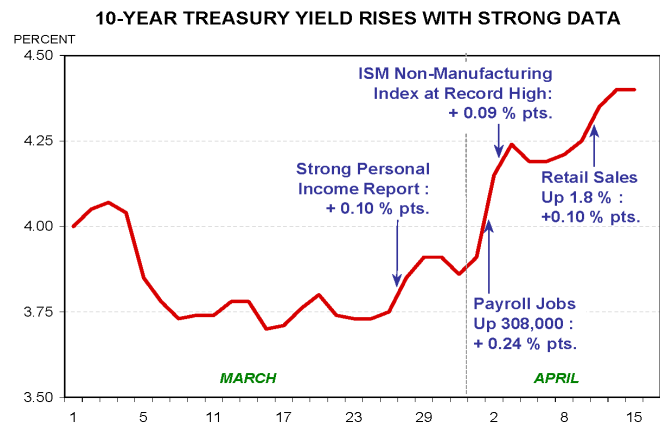
“about unchanged” in March at 5.7 percent, up slightly from 5.6 percent in February. The unemployment rate has been trending down from the 6.3-percent rate of June of last year. At 5.7 percent, the unemployment rate continues to be lower than the average for the 1970s, 1980s, or 1990s. A continued downward trend in new unemployment insurance claims bodes well for further gains in payroll jobs in coming months (see chart).

- **Manufacturing and Investment:** Over the past 5 months, manufacturing activity has reached its fastest pace in 20 years (Institute for Supply Management [ISM] manufacturing index). Manufacturing industrial production flattened out in March, but has increased at a 5.6-percent annual rate since June of last year. New orders and shipments for manufacturers' durable goods – key measures for business investment spending – have shown a strong upward trend since May 2003. Real business equipment investment rose at a 16-percent annual rate during the second half of 2003 – the largest gain in 6 years. The ISM manufacturing employment index showed an improving employment outlook for the fifth consecutive month. Additionally, government estimates showed that manufacturing payroll jobs were unchanged in March from February

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(the first time since July 2000 that manufacturing employment did not decline). According to a recent Manpower survey, the business outlook for hiring is the best it has been in more than 3 years.

- **Retail sales and consumption:** Retail sales increased strongly in March, rising 1.8 percent – the largest monthly gain in a year and a much stronger rise than expected by private analysts. The gains in consumption coincide with strong gains in personal income and the personal tax relief from the Economic Growth and Tax Relief Reconciliation Act of 2003. Through February, real consumption spending and real disposable personal income (after-tax income) were each up by more than 4 percent over the prior 12 months. Although consumer sentiment slipped to 93.2 in the first half of April (from 95.8 in March), sentiment has been on an upward trend from the 77.6 level of March 2003.
- **Additional indicators:** Housing starts rose 6.4 percent in March, and residential construction activity continues at its highest pace in 20 years. Household wealth rose to a record level at the end of 2003, reflecting gains in stock markets and in housing values. The ISM non-manufacturing activity index reached a record high level in March.
- **Energy Prices:** Rising energy prices are a concern, however, with crude oil prices recently running at more than \$36 per barrel – the highest sustained levels since the early 1980s. The nationwide average for regular gasoline prices is \$1.79 per gallon – a record high nominal price – and up more than 10 percent over the past year. (In real, inflation-adjusted terms, gasoline prices reached their record high in early 1981 at about \$2.80 per gallon in today's prices).



- **Inflation, Interest Rates:** Consumer price index [CPI] inflation is up 1.7 percent over the past year – a low rate by historical standards – but with significant increases in recent months. Nonetheless, despite such pressures, private forecasters expect only a gradual increase in inflation going forward (see Blue Chip forecast below). The strong gains in key indicators recently have led to sudden increases in long-term interest rates – reflecting the outlook for a stronger economy. For example, the 10-year Treasury note yield increased from about 3.75 percent in the middle of March to around 4.4 percent in mid-April (see chart above). The interest rate rise is not unexpected; private forecasters have been expecting that interest rates – and inflation – would rise as the economy strengthens (see Blue Chip forecast).

### Outlook for Continued Strong Growth

The Blue Chip consensus of private forecasters projects continued strong growth in the U.S. economy during 2004 and 2005 (see table). Real GDP growth is expected to be in the 4.0- to 4.3-percent range this year and in the 3.4- to 3.6-percent range during 2005. The unemployment rate is expected to continue to gradually decline, falling to 5.4 percent by the end of this year and 5.2 percent by the end of 2005. Inflation and interest rates are expected to rise gradually during 2004 and 2005 as the economy returns to sustained expansion. Two-thirds of the forecasters expect that, due to the economy's strength, the Federal Reserve will raise interest rates before the end of this year.

The Blue Chip forecasters also expect payroll jobs growth to average 153,000 jobs per month this year.

**Blue Chip Economic Outlook, April 2004**

	2003.3	2003.4	2004.1	2004.2	2004.3	2004.4	2005.1	2005.2	2005.3	2005.4
	<i>Actual</i>		<i>Projection</i>							
Real GDP Growth	8.2	4.1	4.3	4.3	4.1	4.0	3.6	3.6	3.6	3.4
Unemployment Rate	6.1	5.9	5.6	5.6	5.5	5.4	5.3	5.3	5.2	5.2
CPI Inflation	2.4	0.7	3.5	1.9	1.7	1.8	2.1	2.1	2.1	2.2
3-month Treasury Bill	1.0	0.9	0.9	1.0	1.1	1.3	1.7	2.1	2.5	2.8
10-year Treasury Note	4.3	4.3	4.0	4.2	4.4	4.6	4.8	5.0	5.2	5.3

Note: Unemployment, CPI inflation, and interest rate values for 2004.1 are actuals and not projections.

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